Nos. 04-805 and 04-814

Supreme Court, U.S.
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In The
Supreme Court of the United States

TEXACO INC.,

Petitioner,

v.

FOUAD N. DAGHER, et al.,

Respondents.

SHELL OIL COMPANY,

Petitioner,

v.

FOUAD N. DAGHER, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF AMICUS CURIAE AMERICAN ANTITRUST INSTITUTE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether a full-blown "rule of reason" analysis – including evidence of clear economic power in a precisely defined market – is essential for a complaint to withstand summary judgment, when the evidence shows that two major competitors (1) incompletely integrated their assets relating to a joint venture's business, and (2) restricted the venture's ability to price the venture's products in order to preserve each firm's own economic interests, with the result that prices inexplicably increased while venture costs were decreasing.

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STATEMENT OF INTEREST OF THE AMICUS CURIAE[1]

The American Antitrust Institute (AAI) is an independent, not-for-profit organization whose mission is to increase the role of competition and sustain the vitality of the antitrust laws. This filing has been authorized by a majority of the directors of the AAI (Albert H. Foer, Esq. and Professor Robert Lande of the University of Baltimore Law School). The Advisory Board of the AAI consists of more than 85 prominent lawyers, law professors, economists and business leaders (listed on the AAI web site: www.antitrustinstitute.org). The Advisory Board serves in a consultative capacity and their individual views may differ from the positions taken by AAI.

A decision that joint ventures are not subject to vigorous antitrust scrutiny could seriously undermine a competitive economy and deny consumers the benefits of competition. Ensuring that well-settled principles of antitrust law remain applicable to joint ventures is essential to vital antitrust enforcement.

STATEMENT

In 1998, two of the major oil companies competing in the western United States[2] began to sell their Shell- and

[1] This brief was not authored in whole or in part by any counsel for a party and no persons or entities other than The American Antitrust Institute made a monetary contribution to its preparation. The written consents of the parties to the filing of this brief have been lodged with the Clerk.

[2] The complaint alleged a nationwide conspiracy, with similar facts challenging Shell- and Texaco-brand pricing in the eastern United

(Continued on following page)

Texaco-brand gasoline through a new business entity named Equilon. Foregoing an outright acquisition of assets by either one of the firms, or the creation of a new corporation that would operate their assets to compete efficiently as a wholly integrated economic unit, the parties chose instead to structure Equilon as a joint venture. Although the agreement provided that Shell and Texaco would each take a fixed percentage of Equilon's profits, the parties continued to compete with each other in geographic markets outside of the United States and in the sale of marine and jet fuel in the United States. The agreement could also be terminated at any time by mutual consent or by either party after five years. Of particular significance, the parties entered into a Brand Management Protocol that required Equilon to preserve the Shell and Texaco brands, to treat each brand equally, and to provide neither brand with preferential treatment. This Protocol makes little business sense if the parties anticipated a permanent end to all competition in the relevant market. In short, the agreement called for the suspension of competition, not the end of competition that necessarily arises from a merger or a similarly complete integration of economic activity.

Respondents developed evidence showing that major oil companies differentiate their products through additives and advertising creating brand loyalty, that Shell customers tended to be more affluent and urban while Texaco customers tended to be more blue collar and rural, and that the tankwagon price of Texaco-brand gasoline

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States by another joint venture named Motiva. To simplify the legal issues, we confine our discussion to the venture's purpose and effect in the western United States.

was generally two cents below other major brands, including Shell. Resp. Br. at 7. Moreover, discovery produced evidence suggesting that marketplace competition did not force Equilon to pass on to consumers the cost savings from jointly refining and distributing gasoline. Resp. Br. at 11-12. At the commencement of the venture, Equilon management maintained the traditional two cent price differential between Shell- and Texaco-brand gasoline, but after eight months, the "Members Committee" of Shell and Texaco officials that controlled Equilon adopted a "Strategic Marketing Initiative" directing Equilon management to charge identical prices in each geographic market for Shell- and Texaco-brand products. (Evidence suggests that Shell and Texaco officials had deliberately refrained from discussing brand pricing prior to the formation of the venture "because of anti-trust concerns." Resp. Br. at 9.) Of greatest significance, Respondents offered evidence that Equilon sharply raised the price of its gasoline, at a time when crude oil prices were stable or declining. Resp. Br. at 11. In particular, Respondents noted significant price increases in West Coast markets where Equilon had large market shares. *Id.*

In their brief, Respondents appear to present alternative theories as to how Shell and Texaco have restrained trade and thus harmed consumers. One theory is that, to preserve each brand in the foreseeable event (which actually occurred three years later) that the venture would be terminated, Shell and Texaco directly and without justification restrained Equilon's ability to compete by insisting on a single price for both brands of gasoline, even if it was in Equilon's interest to pursue a strategy of brand differentiation. A second theory is that in those markets where the combined retail market share of Shell and

Texaco was particularly large, Equilon was able to increase prices dramatically at a time of stable input costs and reduced operating costs, suggesting that Equilon was able to harm consumers through either the use of unilateral market power or coordinated interaction with other major oil companies. The direct evidence produced in discovery supports both these theories, and it is not necessary at this stage of the case to determine which, if either, is correct.

Although we do not endorse all of its reasoning, in our view the court of appeals correctly determined that Respondents' complaint should not have been summarily dismissed. The district court concluded that because the agreement forming Equilon was not a naked restraint of trade, but represented a genuine integration of economic activity that resulted in demonstrable efficiencies, the rule of reason provided the only basis for condemning any agreements by the parties that related to Equilon. This conclusion was erroneous. Because this Court has directed that horizontal restraints require "an enquiry meet for the case" (*California Dental Ass'n v. FTC*, 526 U.S. 756, 781 (1999)), we believe that Respondents' case should have been allowed to proceed as a "quick look" without the need for a precise definition of relevant markets, or a broad conclusion that only a full-blown rule of reason allegation could support the complaint.

Although their joint venture did reflect a genuine integration of many productive assets, Equilon was not a complete integration of all economic activity within the market. If, as evidence in the record suggests, Shell and Texaco structured Equilon to preserve their independent interests in a manner unnecessary to achieve the legitimate fruits of the venture, this unduly restrictive structure can

be condemned under *California Dental* and other Supreme Court precedents without a complete examination of market effects. Moreover, even if Equilon were not structured in an unnecessarily restrictive way, this Court has made it clear that an agreement can be condemned under a "quick look," without precisely defining relevant markets under a full-blown rule of reason, where the plaintiff introduces direct evidence of intent to raise prices and that in fact this intent was achieved. *NCAA v. Board of Regents of the University of Oklahoma*, 468 U.S. 85, 109-10 & n.42 (1984).

At the same time, the court of appeals erred in requiring that all pricing decisions to which a joint venture's principals agree must be separately justified as necessary to achieve the efficiencies that the venture is intended to create. Because the appropriate standard of antitrust analysis under Section 1 of the Sherman Act (15 U.S.C. § 1) should turn on real economic effects rather than "upon formalistic line drawing" (*Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977)), a joint venture should be treated as a single firm for purposes of Section 1 only when there is a complete unity of economic interest among those controlling the venture – *i.e.*, their sole economic interest is in maximizing the competitive ability and profitability of the venture-as-a-whole. Of course, even in such a case, the *formation* of the joint venture is subject to antitrust challenge, and evidence that the venture in fact resulted in unexplained increases in prices suffices to demonstrate an unreasonable restraint of trade.

On remand, Respondents should be given an opportunity to prove that Shell and Texaco created the Brand Management Protocol, required Equilon to treat both brands equally, and adopted the single-price strategy,

contrary to Equilon's interests as an independent competitor. Respondents plausibly suggest that this restraint was motivated to protect each brand in ongoing competition in the sale of jet and marine fuel, to preserve a marketing position in the event that the venture is terminated (on two years notice by either party, or by mutual consent, which did occur three years after Equilon's formation), or to facilitate some more immediate exploitation of consumers. Absent a persuasive, legitimate justification for this arrangement, a reasonable jury could find that Petitioners were more concerned with maintaining the relative strength of their branded gasoline than on profitably and vigorously competing in the automobile gasoline market. Ordinarily, firms ending all competition in a relevant market, and seeking only to profit as "shareholders," would allow the executives in the venture in which they had invested to compete in whatever way best advances the competitive interests of the venture-as-a-whole. Restraining Equilon here suggests, absent some legitimate explanation, that Shell and Texaco were not seeking to create a more efficient competitor in a competitive marketplace, but to profit by lessening competition between the two former rivals, who might again be marketplace foes in the future. Because "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets" (*California Dental,* 526 U.S. at 770), the court of appeals correctly held that the district court erred in granting summary judgment to the defendant. Indeed, if Petitioners provide absolutely no justification for unnecessary price fixing, the price agreement should be condemned as illegal *per se*. *See Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 351-355 (1982).

An alternative ground for affirmance is also apparent, because Petitioners acknowledge that the initial agreement between Shell and Texaco to form Equilon is an agreement between competitors subject to Section 1. For purposes of summary judgment, Respondents have offered sufficient evidence of anticompetitive effect to justify "quick look" condemnation, absent evidence from Shell and Texaco to justify their agreement. Equilon's apparent ability to raise the price of Texaco-brand gasoline without marketplace retribution, and then to continue to raise the price of both brands significantly, at a time when crude oil prices remained stable or declined and venture costs were reduced due to operating efficiencies, suggests that their strategy was designed to signal price coordination to its major rivals. This evidence of unexplained price hikes obviates the need for a precise delineation of relevant product and geographic markets.

SUMMARY OF ARGUMENT

The court of appeals correctly held that the district court should not have summarily dismissed Respondents' antitrust challenge to an anticompetitive pricing scheme derived from the overly restrictive structure of Petitioners' joint venture, especially where record evidence demonstrated actual anticompetitive effect. Contrary to the assertions by Petitioners and their allies, this case does not involve the pricing decisions of a fully integrated joint venture. Rather, the joint venture was designed to maintain the competitive strength of each firm's brand, even if contrary to the best interests of the venture-as-a-whole. Accordingly, this Court's holding in *Copperweld* that Section 1 of the Sherman Act does not apply to intrafirm

agreements has no application to this case. A full-blown rule of reason is not required if, on remand, Respondents can persuade a jury that the challenged pricing strategy was unrelated to the legitimate purposes of the venture and caused anticompetitive harm.

Alternatively, the court of appeals' judgment should be sustained because Respondents introduced evidence that the elimination of competition between Shell and Texaco did in fact raise prices at a time of stable or declining costs. Under this Court's precedents, such evidence is sufficient to demonstrate a violation of Section 1, even in the absence of evidence that Petitioners exercised market power in precisely defined economic markets.

ARGUMENT

Respondents' challenge to the Shell-Texaco joint venture includes evidence that the parties agreed prior to the formation of the Equilon venture that, although overall profits would be shared according to a fixed formula, Equilon would be restrained from pricing Shell-and Texaco-brand products in a manner that might well increase Equilon's profitability. Specifically, Respondents assert that the Brand Management Protocol, requiring that Equilon treat the Shell and Texaco brands equally, was imposed to preserve the principals' overriding concern with "brand management," *i.e.*, the maintenance of the relative strength and consumer appeal of the Shell and Texaco brands. Pursuant to this protocol, absent mutual agreement by Shell and Texaco, even if Equilon determined that its profits could be enhanced by a strategy that emphasized one brand or the other (a common strategy

among multibrand corporations), it was literally restrained from pursuing such a strategy. Petitioners provided no plausible efficiency justification for this restraint.

Two features distinguish joint ventures and mergers from cartels: increased efficiency resulting from economic integration, and business conduct designed to maximize competitive advantage for the venture-as-a-whole, rather than the individual self-interest of co-conspirators. Where a joint venture agreement does not create a "unity of interest" between the parties, but rather is designed to protect the parties' distinct interests (either in other markets or with regard to reentering the market in question), a plaintiff challenging a demonstrably overbroad and unnecessary restraint should not be required to prove its case under the rule of reason. Such a burden would significantly impede the nuanced approach adopted by this Court to prevent joint venture firms from cooperating in ways that yield no economies that will redound to the benefit of consumers.

Even if an antitrust court's inquiry focused on Petitioners' agreement to form Equilon itself as a means to fix prices, rather than the specific decision to charge identical prices, Respondents have presented sufficient evidence of anticompetitive effect to avoid summary dismissal of their claim. As this Court's precedents make clear, direct evidence of higher prices suffices to find an unreasonable restraint of trade absent justification or refutation by the defendant, even if the plaintiff fails to demonstrate the defendant's market power in a precisely defined economically relevant market.

A. *Copperweld* Should Not Apply to Joint Ventures Where the Parties Can Control Venture Operations in Their Own Independent Self-Interest

In *Addyston Pipe*, this Court affirmed a now-landmark decision by then-Judge William Howard Taft finding that a detailed price-fixing conspiracy was illegal under the Sherman Act, "however great the competition they had to encounter." *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 291 (6th Cir. 1898), *modified & aff'd*, 175 U.S. 211 (1899). Yet shortly thereafter, the defendants merged all business operations to form the U.S. Cast Iron & Foundry Co., apparently without objection from the same Justice Department that had prosecuted them. The tolerance of a merger while condemning price fixing illustrates a key insight, recognized by this Court years later in *Copperweld*: a complete integration of all economic activity is unlikely to be anticompetitive absent some demonstration of adverse market effects, because the newly merged venture is presumed to perform as an efficient unit, taking formerly disparate parts and thereafter acting in the best interest of the entity as a whole. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984). In this case, had Equilon been structured as a complete integration, a claim that the integration was unnecessary to achieve efficiencies, or that the efficiencies were outweighed by the simultaneous increase in market power resulting from the cessation of competition between Shell and Texaco, may well require proof of actual anticompetitive effect. (As we contend in Part B, *infra*, the record provides sufficient proof of actual anticompetitive effect to withstand Petitioners' motions for summary judgment.) This Court need not reach the issue of whether *Copperweld* should be extended to fully integrated,

efficiency-enhancing joint ventures; this case, rather, involves a partially integrated joint venture with unjustified and unnecessary pricing restraints.

Intrafirm agreements by a wholly integrated economic unit are not closely scrutinized by courts under either antitrust or corporate law, because the law presumes that in competitive markets the firm's managers will look out for the unit-as-a-whole and the result will be vigorous rivalry. When rivals wholly integrate their economic activity, the integration will often be procompetitive; where the integration simultaneously increases market power and results in efficiencies, only an inquiry into actual competitive effects can determine if this is so. In contrast, when rivals with independent interests combine in ways that are demonstrably unnecessary for any legitimate activity, it is reasonable to presume – even absent reliable evidence about market definition – that the parties themselves recognize that market retribution will not be swift should they seek to use their cessation of competition to exploit consumers. *Cf. Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982) (Posner, J.) ("A firm that has no market power is unlikely to adopt policies that disserve its consumers; it cannot afford to. And if it blunders and does adopt such a policy, market retribution will be swift.").

Moreover, when there is a complete integration of economic activity, absent judicial micromanagement, there is no effective antitrust remedy other than dissolution of the venture. In contrast, unnecessary price agreements that arise in the context of partially integrated ventures can be enjoined by the court while the unchallenged and legitimate aspects of the venture proceed unfettered.

Citizen Publishing Co. v. United States, 394 U.S. 131 (1969).

Extending *Copperweld* to this joint venture is unwarranted not only because of the potential to exercise market power, but also because the venture's founders, acting in their own self-interest, inhibited the joint venture's ability to compete effectively and efficiently with others. *Cf.* Joseph F. Brodley, *Joint Ventures and Antitrust Policy,* 95 Harv. L. Rev. 1521 (1982) (in contrast to a merger, joint ventures create a problem of two masters). In any partnership where the payoffs to decisions are shared, economists have observed that the marginal benefit to each partner accruing through the arrangement is smaller than the total benefit, and therefore no partner has the incentive to act in ways which maximize total payoffs. The most efficient allocation of resources requires the services of a "residual claimant," a separate economic actor who has the incentive to make optimal decisions, make whatever side payments are necessary to achieve the desired result, and then retain the surplus. *See, e.g.*, Bengt Holmstrom, *Moral Hazard in Teams,* 13 Bell J. Econ. 324 (1982); Armen A. Alchian & Harold Demsetz, *Production, Information Costs and Economic Organization,* 62 Am. Econ. Rev. 777 (1972). Here, if Shell had purchased Texaco outright, then Shell would be the residual claimant. As the venture was in fact structured, however, there was no entity with the incentive to behave efficiently.[3]

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[3] An Equilon strategy that benefitted the Shell brand at the expense of the Texaco brand might still be pursued, but only if Shell and Texaco could agree on side payments to make them both better off; the above-cited economic literature suggests that transactions costs will

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This Court has consistently held that joint ventures structured so that individual self-interest prevails over the interests of the venture-as-a-whole are suspect under the Sherman Act. In *Associated Press*, this Court struck down a bylaw allowing local newspapers to veto admission of their competitors into a news-gathering joint venture. *Associated Press v. United States*, 326 U.S. 1 (1945). Certainly, the venture-as-a-whole would have been enhanced with the admission of a second news-gathering source in major cities. Yet each party, looking out for its own individual self-interest, preferred the modest reduction in the quality and breadth of AP news to the risk that a direct rival might benefit by access to the venture's output.[4]

A similar local veto was struck down in *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972). The lone dissent objected to the close scrutiny given to the joint venture's arrangement, arguing that there was no difference between the challenged territorial restrictions among rivals cooperatively owning trademarked goods for sale, and the perfectly lawful decision by a single firm operating grocery stores (such as the A&P chain) deciding where to locate its stores. *Id.* at 623 n.11 (Burger, C.J., dissenting).

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often prevent the efficient result from occurring without a residual claimant.

[4] To be sure, the parties might claim that the restriction was reasonably necessary to avoid free-riding and to secure and maintain the membership of important contributors. This is precisely the sort of justification that courts should consider under Section 1. Extending *Copperweld* to *Associated Press* would eliminate scrutiny of whether the parties' justification was valid. Here, of course, the record provides no serious claim that tying Equilon's hands through the Brand Management Protocol had any legitimate justification.

Although *Topco*'s summary refusal to allow the defendant *any* opportunity to justify its arrangement has attracted widespread criticism, and may not reflect this Court's approach after *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979), the majority was correct in failing to accept the dissent's reasoning. To illustrate, suppose that A&P operated a store in Michigan City, Indiana, and an analysis showed that opening a new outlet in nearby Long Beach could drain between $25,000 and $75,000 annually in operating profits from the existing store; nonetheless, A&P would surely proceed with the new store if it estimated that the new store would recoup over $100,000 in profits. On the other hand, a Topco member operating a Michigan City store would not consent to allowing a rival to open a store in Long Beach, absent a side payment, and the parties may well have considerable difficulty in agreeing upon such a payment.

The decision in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), demonstrates this Court's sensitivity to the structure of a joint venture. The defendant company licensed a popular trademark for mattresses and imposed territorial restrictions on licensees. The defendant claimed that the agreement was a vertical agreement; this Court rejected this claim, noting that the licensees controlled the decision and that the territorial restrictions furthered their self-interest in manufacturing mattresses without competition from their fellow venturers. Because "Sealy, Inc., is an instrumentality of the licensees," rather than functioning as the "principal," the arrangement was condemned as illegal *per se*. *Id.* at 354, 357-58.

A distinction between a structure promoting the distinct interests of separate principals and promoting the venture-as-a-whole was again recognized by this Court in

Copperweld. Indeed, Petitioners seem to accept this distinction, in emphasizing repeatedly and correctly one important and (in this context) procompetitive aspect of Equilon's structure: that Shell and Texaco receive revenues based on a percentage of Equilon's operating profits, rather than based on profits or sales of Shell- or Texaco-branded gasoline. Texaco Br. at 4. The implication of this assertion is clear: if Equilon had been created with joint price-setting by Shell and Texaco, but a structure whereby accountants would allocate profits to Shell based on the sale of Shell-brand products and to Texaco based on Texaco-brand sales, *Copperweld* would be inapplicable even though the venture reflected a complete integration of physical and trademark assets expected to create significant efficiencies.

Similarly, Respondents have produced sufficient evidence for a reasonable jury to find – contrary to Petitioners' claims – that the parties *did not* establish a joint venture that reflected a complete integration of all economic activity within the western United States, notwithstanding the profit-sharing agreement. Respondents' evidence shows that this is decidedly *not* the equivalent of what would have occurred had a new corporation, Equilon, purchased all relevant assets from both Shell and Texaco, or if one of the parties had acquired all the assets from the other. In none of these scenarios would Equilon's management have had to labor under a protocol requiring equal treatment of branded products. Instead, they would have had a fiduciary duty to price Equilon products to maximize competitive advantage for the newly formed entity. *Cf. Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1148 (9th Cir.) (Kozinski, J.) (lack of fiduciary duty suggests that venture is not a single entity under

Copperweld), *cert. denied*, 540 U.S. 940 (2003). Any pricing decisions freely made by Equilon management would raise competitive problems only if the elimination of competition between Shell and Texaco produced adverse marketplace effects, presumably through coordinated interaction among remaining sellers or unilateral market power, and could sensibly be enjoined only by dissolving the venture. In contrast, the Brand Management Protocol can be stricken as illegal while the procompetitive aspects of the venture can proceed.[5]

In short, this is not a challenge to the "right of a legitimate joint venture to set the selling price of *its own products*" (Texaco Br. at 1 (emphasis added)), but to the decision of the principals to restrain a legitimate joint venture's ability to compete in the market. Respondents allege that Shell and Texaco structured Equilon in a manner that required the venture to protect both brands, regardless of market conditions or whether such a protocol would benefit consumers or Equilon as a distinct and separate entity. If the parties were simply "shareholders" in Equilon (Texaco Br. at 3, 13), why would they have insisted on the Brand Management Protocol requiring Shell and Texaco brands to be treated equally? Why wouldn't each shareholder want Equilon to price in a manner that results in the greatest short-term profit or long-term competitive advantage for Equilon? Given the traditional product differentiation between the two

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[5] The fact that Shell, Texaco, or both might not have agreed to enter into the joint venture without the additional carrot of an anti-competitive and unnecessary price-fixing agreement cannot justify the agreement. Otherwise, joint ventures truly would become covers for price fixing. *Cf. Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 598 (1951).

brands, with Shell preferred by more urban and affluent consumers, one would expect that Equilon's managers would be given the discretion to select a pricing scheme most likely to advance Equilon's interests, because overall profits are shared on a fixed basis by Shell and Texaco. The unexplained insistence on treating brands equally is difficult to understand if, as Petitioners and their allies maintain, the agreement ended all competition between Shell and Texaco in the western United States and had no effect on their rivalry in other markets.

Because the record provides no legitimate reason for this decision, a reasonable jury could infer that Equilon's ability to compete would not have been restrained *unless* this limitation had some effect in other markets. Each party may have feared that relative success of the other brand in gasoline markets would affect its continued rivalry in markets for marine or airport fuel. An aggressive pricing strategy by Equilon management in the western United States – perhaps to take advantage of the significant cost savings realized by the merger – could invite retaliation against Shell and/or Texaco in foreign markets. Recognizing the impermanency of the venture, each party may have resisted the temptation to maximize Equilon profits through innovative brand pricing, preferring the safety of brand maintenance in the event of resumption of competition between the two parties should the venture be terminated. The point at this stage of the litigation is not whether any of the foregoing theories accurately describe market realities; rather, if the parties fail to plead and offer some proof of a legitimate justification, since Respondents have come forward with a plausible theory of competitive harm, the jury is entitled to find that the agreement can have no function other than to

harm competition. If a jury could so find, then the assertion that "neither Shell nor Texaco had a specific interest in the price charged for any particular brand sold by the ventures" (Texaco Br. at 4), is simply inaccurate.

This Court need not determine the purpose of the challenged provision of the Brand Management Protocol at this stage of the proceedings. It is sufficient for Respondents to demonstrate, as they have done, that there is a significant possibility that the agreement was not imposed by Shell and Texaco simply as shareholders in Equilon, but rather to pursue their own interests outside of the venture. Petitioners seek to contrast the formation of the venture, concededly subject to Section 1 scrutiny, with post-formation internal decisions about the manner in which the venture operates. However, the thrust of Respondents' challenge to the Brand Management Protocol goes to the preformation structure, not to post-formation operation. Respondents allege that, prior to formation, Shell and Texaco agreed that Equilon would not, post-formation, adopt a potentially profit-maximizing strategy if it resulted in a preference for one brand over the other. Thus, the legality of the Brand Management Protocol is a legitimate object of antitrust scrutiny under Section 1 as an agreement among competitors.[6]

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[6] Petitioners and their allies incorrectly characterize Respondents' lawsuit as simply a challenge to post-formation decisions. Their implication that the FTC's consent decree immunizes any agreements Shell and Texaco may have made (*see, e.g.*, Texaco Br. at 25 (dismissing concerns as already "accounted for in evaluating the venture's formation and structure"); Visa U.S.A. et al. Br. at 4 (FTC and state attorney general review "resolved the issue of Equilon's legality")), is wrong legally as well as factually.

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It is critical that antitrust scrutiny of joint ventures adhere to Judge Richard Posner's observation that it "does not follow that because two firms sometimes have a cooperative relationship there are no competitive gains from forbidding them to cooperate in ways that yield no economies but simply limit competition." *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 594 (7th Cir. 1984). Application of this Court's precedents fulfill that promise, and suggest that summary judgment is not appropriate in this case. When price fixing is an "obvious necessity" in order to produce a joint product, *Broadcast Music* holds that the normal condemnation of such conduct as *per se* illegal is inappropriate. By the same token, when it is clear that the challenged price fixing is not necessary to accomplish the venture's legitimate purposes, *Maricopa* holds that the price fixing is condemned as illegal *per se*. If the record on remand

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As a legal matter, it is clear that private parties are not bound by FTC decisions and are free to file a private lawsuit under Section 1 to challenge a venture's structure. Gov't Br. at 16 n.10. The principal thrust of our argument is that blatantly anticompetitive and unjustified aspects of a venture's structure can be condemned under the antitrust law without a full rule of reason analysis requiring the precise definition of relevant markets or proving actual adverse effects on competition. (We argue in Part B, *infra*, that Respondents have in fact provided sufficient evidence of the latter.) The competition policy question of whether private suits under Section 1 should be allowed to challenge business practices like the formation of integrated joint ventures, or whether such suits must be brought prior to the commencement of joint operations, is best addressed to Congress or the Antitrust Modernization Commission, not this Court.

Moreover, as a factual matter, there is no evidence that the FTC in fact scrutinized and approved the portion of the agreement that required Equilon to set prices in order to protect the Shell and Texaco brands. Rather, the FTC analyzed the venture as if it were a complete merger between firms previously competing in various local markets.

includes disputed evidence regarding the necessity for price fixing in the context of a partially integrated joint venture, then, as in *NCAA*, 468 U.S. at 110 n.42, a closer but more focused inquiry is appropriate, but not necessarily the full economic record required under the full-blown rule of reason contemplated by *Board of Trade of Chicago v. United States*, 246 U.S. 231, 238 (1918). As Robert Bork has observed, "if you have an actual integration in some sense but the restraint is broader than anything that the integration would justify, to that extent it is a naked restraint. You shouldn't put up with it." *Paradox Revisited: Interview with Judge Robert H. Bork*, 3 Antitrust 16, 18 (Summer 1989).

We agree with Petitioners that if the undisputed facts had demonstrated that their agreement reflected a complete integration of all joint venture business activity in the relevant market, or if they had demonstrated that identical-brand pricing was reasonably necessary to allow Equilon to operate, then antitrust liability should only attach on proof that the actual anticompetitive effect of the venture outweighed its procompetitive benefits.[7]

[7] The only justification put forth by the parties for their mandate to set identical prices for Shell- and Texaco-brand products was to avoid liability for price discrimination under the Robinson-Patman Act. Whether there are disputed facts to suggest this is unnecessary or pretextual is best left for the district court on remand. We note, however, that conformance with the Robinson-Patman Act does not require a broad promise to treat both brands equally as the Brand Management Protocol requires. Moreover, although Shell and Texaco obviously have a keen interest in ensuring that their Equilon venture not incur liability for illegal activity, we doubt that the principals specified in their agreement every single aspect of law to which Equilon's managers need comply. On remand, the district court might legitimately explore why Equilon's management could not be trusted to ensure that it complied with antitrust laws in its ongoing operations,

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Likewise, Respondents' claim that identical-brand pricing was anticompetitive because the elimination of interbrand competition between Shell and Texaco allowed Equilon to increase prices through the exercise of unilateral market power or by coordinating with major rivals should require proof of actual anticompetitive effect. But that does not justify summary dismissal here: the facts show neither a complete integration nor the necessity of identical-brand pricing, and, as we claim in Part B, *infra*, Respondents have presented sufficient evidence of actual anticompetitive effect.

The United States' argument reaches much too far in suggesting that any agreement among competitors that integrates economic activity is immune from *per se* analysis no matter how unnecessary its restrictions are. This would be inconsistent with this Court's approach in *Copperweld*, as further explicated by Judge Posner in *General Leaseways*. Both these decisions suggest the continuing need for antitrust scrutiny where venturers retain the ability to restrain the venture to promote individual self-interest. Moreover, to require a plaintiff challenging a demonstrably overbroad restraint to delineate precisely a relevant market under a full-blown rule of reason will significantly impede the careful and surgical use of this Court's nuanced approach, inappropriately

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and, if Robinson-Patman compliance was so apparent, why it took the parties eight months to realize this. In any event, this Court has cautioned that price fixing that is otherwise illegal under the Sherman Act cannot be justified as an effective means of limiting liability under the Robinson-Patman Act. *United States v. United States Gypsum Co.*, 438 U.S. 422, 458-59 (1978).

allowing firms with a cooperative relationship to agree in ways that yield no economies.[8]

The FTC's consent decree with regard to Equilon's formation does not obviate the need for antitrust scrutiny of the challenged price agreement. There is no record evidence that the FTC was informed that Equilon's ability to compete in the gasoline market against several established rivals would be restrained by the parties' Brand Management Protocol.[9] Moreover, the fact that the Commission chose to settle rather than challenge in its entirety the creation of a venture with demonstrated efficiencies in refining and wholesale distribution (the parties failed to cite any efficiencies related to the joint operation of retail outlets), falls far short of meeting Judge Posner's sound test for the absence of market power: that firms facing vigorous rivalry will be unlikely to harm consumers, and, if they do, "market retribution will be

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[8] It is surprising that the Government seems to view joint venture analysis *entirely* from the lens of merger analysis. For example, in discussing Professor Areeda's famous illustration of the rule of reason in a "twinkling of an eye," a hypothetical sales joint venture between Ford and General Motors, the Government correctly observes that the *formation* of the venture was obviously anticompetitive, but then assumes that the FTC's review of the creation of Equilon precludes a conclusion that an undisclosed interpretation of the Brand Management Protocol to promote the independent interests of Shell and Texaco is now beyond antitrust scrutiny. Determining, under a merger analysis, whether a proposed business arrangement will result in coordinated interaction or market power is complex enough. Surely the Government should want the flexibility to challenge blatantly anticompetitive structural aspects of joint ventures without the need to meet the burden of proof required by the Merger Guidelines.

[9] *See* Texaco Br. at 4 (FTC evaluated the agreement as a complete merger on the assumption that the venture would operate as a single entity).

swift." *Valley Liquors*, 678 F.2d at 745. Of far greater significance, even if the FTC had definitively determined that, using all the expertise at its disposal, it was unable *ex ante* to demonstrate a probable anticompetitive effect, this cannot insulate an agreement where Petitioners have established, *ex post*, actual evidence of increased prices of the sort that economic theory suggests can only occur from the significant lessening of competition that the antitrust laws prohibit.

B. Direct Evidence of Anticompetitive Harm Is Sufficient to Warrant a "Quick Look" and Demand a Procompetitive Justification from Defendants, Without the Need to Precisely Define Relevant Markets

As Dean Pitofsky, Professor Goldschmid, and Judge Wood observe in their leading antitrust casebook, in "theory and practice, relevant market definition is as difficult an undertaking as any in antitrust." Robert Pitofsky et al., *Cases and Materials on Trade Regulation* 185 (5th ed. 2003). This insight is critical to the continuing evolution of the appropriate means of antitrust review for agreements among competitors. As stated in *California Dental*, 526 U.S. at 781, what is required is an "enquiry meet for the case." Petitioners and their allies devote virtually their entire argument to the question whether their conduct is illegal *per se*, *i.e.*, conduct so blatantly anticompetitive that it will be summarily condemned without any opportunity for consideration of justifications or market effect. They do so in the hopes that a reversal from this Court will require Respondents here, and anyone else challenging demonstrably overbroad or unjustified aspects of legitimate joint ventures, to embark upon the

difficult (and, in light of modern litigation costs, expensive) task of considering all relevant evidence under a full-blown rule of reason. *Cf. Board of Trade of Chicago*, 246 U.S. at 238.

However, as Chief Judge Douglas H. Ginsburg recently observed, this Court's approach "has gone through a transition over the last twenty-five years, from a dichotomous categorical approach to a more nuanced and case-specific inquiry." *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 33-34 (D.C. Cir. 2005). This more nuanced approach properly reflects the difficulty of proof in a rule of reason case. As the former General Counsel of the Federal Trade Commission insightfully observes, litigating this case under the rule of reason would be a "defendants' paradise." Stephen Calkins, *California Dental Association: Not a Quick Look But Not the Full Monty*, 67 Antitrust L.J. 495, 521 (2000).

A quicker look at suspect agreements, in lieu of a "more sedulous one" (*California Dental*, 526 U.S. at 781), not only promotes business certainty and litigation efficiency (*Maricopa*, 457 U.S. at 343-44), but also can serve in some cases to eliminate rather than create error costs. To be sure, the risk of a "false positive" – a holding striking down a restraint using a *per se* or "quick look" approach when in fact the agreement did not harm competition – often counsels in favor of a more complete inquiry into actual effects. However, this Court's "nuanced" approach should be maintained to avoid the risk of a "false negative" – where the plaintiff's inability to demonstrate market power to the satisfaction of the trial judge exonerates clearly anticompetitive behavior of the sort that would be unlikely to be effective in the absence of such power. *Cf. United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.)

(affirming district court's conclusion that Microsoft possessed monopoly power because, *inter alia*, its conduct would make little sense if Microsoft faced significant rivals), *cert. denied*, 534 U.S. 952 (2001); Willard F. Mueller, *The* Sealy *Restraints: Restrictions on Free Riding or Output?* 1989 Wisc. L. Rev. 1255, 1267 n.74 (1989) (order on remand in *Topco* enjoining overbroad restraints but permitting more narrowly tailored restrictions permitted Topco to grow by 74% from 1967-85).[10]

This Court has repeatedly held that a price increase is the "hallmark" of an antitrust violation (*NCAA*, 468 U.S. at 113), and that direct evidence of price increases suffices to demonstrate an unreasonable restraint of trade, without the need for precise market definition (*FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 459 (1986); *NCAA*, 468 U.S. at 110 n.42). Indeed, this Court expressly endorsed the Solicitor General's view that if a plaintiff provides direct evidence of price distortions, there is "'no need for the respondents to establish monopoly power in

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[10] The problem with false negatives has been recognized by commentators in Canada, where the relevant competition statute does not allow anything short of a "more sedulous" determination that those accused of a conspiracy to restrain trade have the power to "lessen competition unduly." For example, in *R. v. Clarke Transport Canada Inc.*, 130 D.L.R. (4th) 500 (1995), the government established a 21-year conspiracy to fix prices among railroad freight forwarders, including boycotts of noncooperating forwarders. Yet the defendants were acquitted at trial because the judge concluded that the relevant market included freight trucks. The judge did not explain why the defendants would spend over two decades conspiring if any effort to secure supra-competitive prices would be checked by competition from truckers. The problem with this sort of false negative is among the reasons why Canadian experts have advocated legislation creating some form of *per se* illegality. *See, e.g.*, Presley L. Warner & Michael J. Trebilcock, *Rethinking Price-Fixing Law*, 38 McGill L.J. 679, 690-92 (1993).

any precisely defined market . . . in order to prove the restraint unreasonable.'" *NCAA*, 468 U.S. at 110 n.42.

In opposing Petitioners' motions for summary judgment before the district court, Respondents presented credible evidence of significant price increases at a time when input prices were low and when operating costs were being reduced through efficiencies. The evidence also shows that Shell and Texaco executives appreciated the potential for Equilon to exercise price leadership through the single-price strategy. Resp. Br. at 9. The representations by Respondents' counsel that they wished to proceed under a "quick look," and not under the rule of reason, is best understood as foregoing proof of anticompetitive harm by defining relevant markets. To suggest that this sort of record warrants summary dismissal because Respondents failed to precisely define markets is to suggest that the complaints in *Indiana Federation of Dentists* or *NCAA* should have been likewise dismissed prior to trial, when in fact this Court found the defendants liable in both cases.

The sparse record here illustrates why the Solicitor General was correct in *NCAA* and why this Court properly endorsed his view that direct effects obviate the complexity of market definition. As this Court recognized in *State Oil Co. v. Khan*, 522 U.S. 3 (1997), retail gasoline markets are often highly localized. A reasonable jury could infer that if the relevant market were vigorously competitive, Equilon would not have been able to raise the price of Texaco-brand gasoline without losing money to other rivals unless they were engaged in price coordination, and that the "single price" strategy was an effective tool that

Equilon used to signal a desire to coordinate prices at a higher level.[11]

Reviewing a proposed venture *ex ante*, the FTC must make its best estimate as to the location of firms whose competition can prevent the parties from imposing a small but significant price increase on consumers, and having done so, whether conditions will permit the remaining firms to engage in price coordination. Where, as here, the matter was settled by consent decree, the FTC must make a further prediction that the required asset divestitures will frustrate any efforts by the parties or other major rivals in the market to coordinate their prices. Presumably, the FTC made each of these predictions here in permitting Equilon to go forward. The *ex ante* prediction that rivalry from other firms would prevent any consumer exploitation is, however, inconsistent with the *post hoc* record evidence that Equilon did *not* feel constrained to pass on cost savings to consumers, or with the record evidence of significant price increases in light of stable input prices. Of course, Petitioners are free to challenge Respondents' evidence as unreliable or inaccurate. That is what trials are for.

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Petitioners and their allies repeatedly emphasize that Equilon's profits are distributed on a percentage basis, not based on the economic performance of specific brands. Implicit in this argument is the recognition that if Equilon's profits were distributed to each party based on

[11] Alternatively, the jury might infer that because of the specific preferences of Shell and Texaco consumers or their large market share in localized markets, Equilon was able to raise the Texaco prices and then the prices of both brands, notwithstanding reduced operating costs and stable crude oil prices, because of unilateral market power.

performance of their own brands, the venture would likely have faced an antitrust challenge. A holding from this Court that Respondents' claims should not be summarily dismissed will simply reinforce the current legal environment where (1) naked restraints are summarily condemned, (2) complete economic integrations are examined under merger standards, and (3) partial economic integrations are examined under the spectrum of standards recognized by *NCAA* and *California Dental* that this Court has employed in interpreting Section 1 of the Sherman Act. A judgment of affirmance will not second-guess a wholly integrated business entity's unrestrained decision on the price to sell "its" products. Proof of anticompetitive effect will still be required for partially integrated joint ventures when it appears that any restraint on the venture's independent discretion is reasonably related to the parties' legitimate interests. The question is not antitrust review of "bad" management (*cf.* Gov't Br. at 28), but management restrained by two rivals who may have sought to preserve their competitive position for future market reentry, and whose joint decisions have demonstrably raised prices. And, of course, ultimately plaintiffs cannot collect a penny in actual damages for price fixing without proof that the challenged scheme actually caused higher prices. *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 345 (1990).

This Court has unequivocally held that the appropriate standard of antitrust analysis under Section 1 should turn on "actual market realities" rather than "formalistic distinctions." *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 466-67 (1992). Where the actual economic effect of a joint venture is the same as that of a merger – the creation of a fully integrated business

entity operated to maximize overall profits for its owners – the form of the entity should not permit scrutiny beyond what Section 7 of the Clayton Act (15 U.S.C. § 18) requires for mergers. But what is sauce for the goose is good for the gander: where the parties form a joint venture but inexplicably restrain the venture's ability to profit, and economic theory plausibly explains such a restraint as facilitating the parties' ability to succeed in other markets or should they choose to resume competition with each other, than it would be an act of formalistic line drawing to bar the courts from the sort of analysis of overbroad horizontal restraints that they have engaged in from the early developments of the common law of restraint of trade.

CONCLUSION

The judgment of the Court of Appeals, reversing the district court's granting of Petitioners' motion for summary judgment, should be affirmed. Because Petitioners' argument seems largely premised on factual assertions that are disputed, or on a misunderstanding of Respondents' "waiver" of a full-blown rule of reason requiring precise delineation of relevant markets in favor of a "quick look" claim that includes direct evidence of actual economic impact, this Court may alternatively wish to dismiss the writ of certiorari as improvidently granted.

Respectfully submitted,

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